

Message Text

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ACTION EUR-12

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FM AMEMBASSY OTTAWA
TO SECSTATE WASHDC PRIORITY 6408
INFO AMCONSUL MONTREAL
ALL OTHER CONGENS IN CANADA POUCH

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DEPT. PASS CEA, TREAS, FRB

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TAGS: EFIN, ECON, CA
SUBJECT: RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

1. SUMMARY. STRONG DOWNWARD PRESSURE ON CANADIAN DOLLAR EXCHANGE RATE DEVELOPED IN WEEK ENDING FEBRUARY 17. EFFECTS OF DOLLAR WEAKNESS RIPPLED THROUGH CAPITAL MARKETS LEADING TO HIGHER INTEREST RATES. GOC ANNOUNCED PLANS TO DRAW DOWN U.S.DOLS 1.5 BILLION STANDBY CREDIT AND TO ARRANGE ADDITIONAL FOREIGN BORROWING (SEE SEPTTEL). OFFICIAL INTERVENTION APPEARS TO BE AIMED AT KEEPING EXCHANGE MARKET OFF BALANCE. GOC EXCHANGE RATE POLICY HAS DRAWN SHARP CRITICISM FROM POLITICAL OPPOSITION. DOMESTIC ECONOMY CONTINUES TO MOVE MODESTLY UPWARD. INDUSTRIAL PRODUCTION UP 0.2 PERCENT IN DECEMBER AND ROSE 3.3 PERCENT ON AVERAGE IN 1977; GROWTH OF CONSUMER CREDIT TAILED OFF SLIGHTLY AT YEAR END. STATCAN STUDY SHOWS FOREIGN OWNERSHIP CONCENTRATED IN LARGE FIRMS. END SUMMARY.

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2. EXCHANGE MARKETS. EXCHANGE MARKETS UNSETTLED IN WEEK ENDING FEBRUARY 17 AS STRONG DOWNWARD PRESSURE ON CANADIAN DOLLAR EXCHANGE RATE DEVELOPED. AVERAGE EXCHANGE RATE FOR WEEK WAS .8966 COMPARED WITH .9007 PREVIOUS WEEK. SELLING PRESSURE CONTINUED EARLY THIS WEEK AND EXCHANGE RATE DIPPED BRIEFLY BELOW 89 U.S. CENTS ON FEBRUARY 20.

3. LAST WEEK'S CANADIAN DOLLAR DECLINE PARTLY RESULT OF
SPECULATION AGAINST U.S. DOLLAR, BUT ALSO ATTRIBUTABLE TO

STATEMENTS BY PM TRUDEAU AND FINANCE MINISTER CHRETIEN THAT
GOC WOULD NOT INTERVENE TO SUPPORT ANY PARTICULAR LEVEL OF
EXCHANGE RATE. CHRETIEN SAID THAT GOC DID NOT INTEND TO
RAISE INTEREST RATES TO DEFEND DOLLAR. GOC SUBSEQUENTLY
ANNOUNCED THAT IT WOULD DRAW DOWN U.S.DOLS 1.5 BILLION
STANDBY CREDIT ARRANGED THROUGH CHARTERED BANK CONSORTIUM
LAST FALL AND WOULD MAKE ARRANGEMENTS FOR ADDITIONAL BORROW-
ING ABROAD (SEE SEPTTEL). CURRENCY TRADERS REPORT THAT
THERE WAS LITTLE EVIDENCE OF GOC INTERVENTION IN EXCHANGE
MARKET TO SUPPORT DOLLAR LAST WEEK. HOWEVER, OFFICIAL
PURCHASES OF CANADIAN DOLLARS INCREASED SHARPLY EARLY THIS
WEEK AS DOWNWARD PRESSURE ON DOLLAR INTENSIFIED.

4. PROGRESSIVE CONSERVATIVE FINANCE CRITIC SINCLAIR
STEVENS CRITICIZED GOC INTERVENTION POLICY, ASKING POINTED-
LY IF THERE EXISTED A "SHAME LEVEL" BELOW WHICH GOC WOULD
NOT PERMIT DOLLAR TO FALL. CHRETIEN REITERATED GOC POLICY
ALLOWING DOLLAR TO FLOAT. BANK OF CANADA SPOKESMAN
SECONDED THIS POSITION, ADDING THAT INTERVENTION TO CORRECT
DISORDERLY MARKET CONDITIONS WOULD CONTINUE TO TAKE PLACE.

5. COMMENT. GOC CONTINUES TO HOLD VIEW THAT FUNDAMENTAL
MARKET FORCES SHOULD BE ALLOWED TO DETERMINE PATH OF
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EXCHANGE RATE IN LONG RUN. HOWEVER, CONTINUATION OF STRONG
DOWNWARD PRESSURE ON CANADIAN DOLLAR FOR VERY LONG WOULD
RAISE UNCOMFORTABLE POLICY DILEMMA. INCREASE IN INTEREST
RATES TO ATTRACT SHORT TERM CAPITAL FLOWS AND ALLEVIATE
PRESSURE ON EXCHANGE RATE COULD WEAKEN INVESTMENT INCEN-
TIVES AND THE LESS THAN ROBUST CURRENT ECONOMIC EXPANSION,
AS WELL AS AFFECT THE GROWTH RATE OF THE MONEY SUPPLY
WHICH IS NOW ABOUT ON TARGET. ON THE OTHER HAND, MAIN-
TENANCE OF EXISTING INTEREST RATES AND THE LOW DIFFEREN-
TIALS WITH THE U.S. COULD WEAKEN THE EXCHANGE RATE, ADDING
ANOTHER ELEMENT OF INFLATIONARY PRESSURE.

6. OFFICIAL INTERVENTION OPERATIONS OVER PAST WEEK SUGGEST
THAT GOC'S DAY TO DAY INTERVENTION TACTICS MAY BE AIMED
AT KEEPING MARKET OFF BALANCE SO AS TO PREVENT CUMULATIVE
BUILD-UP OF SPECULATIVE PRESSURE AGAINST DOLLAR. HEAVY
SELLING PRESSURE LAST WEEK ELICITED MINIMAL OFFICIAL
RESPONSE, BUT GOC ENTERED MARKET STRONGLY EARLY THIS WEEK.
LATTER ACTION SENT SPECULATORS SCRAMBLING TO BUY CANADIAN
DOLLARS THEY HAD SOLD IN EXPECTATION OF FURTHER DEPRECIA-
TION.

7. CAPITAL MARKETS. EFFECTS OF CANADIAN DOLLAR WEAKNESS RIPPLED THROUGH CAPITAL MARKETS CAUSING SHORT AND LONG TERM INTEREST RATES TO RISE. INTEREST RATE ON 90 DAY TREASURY BILLS WAS 7.26 IN WEEK ENDING FEBRUARY 17, UP FROM 7.20 PREVIOUS WEEK. LONG TERM INTEREST RATES ARE UP AS WELL. ONTARIO HYDRO BONDS YIELDED 9.37 PERCENT WHEN ISSUED IN EARLY JANUARY, BUT NOW YIELD 9.77 PERCENT.

8. INDEX OF INDUSTRIAL PRODUCTION ADVANCED 0.2 PERCENT IN DECEMBER TO 125.6 (1971 EQUALS 100), PRODUCING INCREASE OF 3.3 PERCENT ON AVERAGE IN 1977. SECTORS SHOWING GREATEST RELATIVE STRENGTH IN 1977 INCLUDED NON-METAL MINES (PLUS

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10.3 PERCENT), RUBBER AND PLASTICS (PLUS 12.2 PERCENT), WOOD INDUSTRIES (PLUS 7.7 PERCENT) AND CHEMICALS (PLUS 11.0 PERCENT). MANUFACTURING OUTPUT INCREASED BY 3.1 PERCENT. SECTORS EXHIBITING SUBSTANTIAL DECLINES DURING YEAR WERE LEATHER INDUSTRIES (MINUS 11.7 PERCENT), KNITTING MILLS (MINUS 7.2 PERCENT) AND FURNITURE INDUSTRIES (MINUS 10.4 PERCENT) AND ELECTRICAL PRODUCTS (MINUS 4.0 PERCENT). SECTORAL PATTERN OF OUTPUT GROWTH IN 1977 ILLUSTRATES STRUCTURAL WEAKNESS OF IMPORTANT SECTORS (EG. TEXTILES, LEATHER, FURNITURE), MANY OF WHICH ARE CONCENTRATED IN QUEBEC.

9. SLOW GROWTH OF INDUSTRIAL PRODUCTION MIRRORED BY TREND IN CAPACITY UTILIZATION RATES IN MANUFACTURING. ACCORDING TO FEBRUARY 21 STATCAN RELEASE, UTILIZATION RATE IN MANUFACTURING STOOD AT 83.5 PERCENT IN FOURTH QUARTER OF 1977,

DOWN SLIGHTLY FROM 83.6 PERCENT RATE REGISTERED IN THIRD QUARTER. STATCAN FIGURES SHOW PEAK UTILIZATION RATE OF 92.4 PERCENT IN FOURTH QUARTER OF 1973. THUS, MANUFACTURING SECTOR HOVERS AT ABOUT 9.6 PERCENT BELOW FULL CAPACITY. UTILIZATION RATE IN DURABLES MANUFACTURING ROSE SLIGHTLY IN FOURTH QUARTER, WHILE NON-DURABLES DECLINED. LIMITED OFFICIAL USE

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10. CONSUMER CREDIT OUTSTANDING REACHED CDOLS 24.4 BILLION IN DECEMBER, UP 11.8 PERCENT FROM LEVEL OF DECEMBER, 1976. RISE IN CONSUMER CREDIT IN 12 MONTHS TO DECEMBER REPRESENTS DECELERATION FROM 12.3 PERCENT AVERAGE INCREASE RECORDED OVER PREVIOUS THREE MONTHS AND IS CONSISTENT WITH YEAR END TAPERING OFF OF RETAIL SALES (SEE OTTAWA 756).

11. EXTERNAL DEVELOPMENTS. RECENT STATCAN SURVEY OF 29,812 COMPANIES SHOWS THAT FOREIGN OWNERSHIP OF CANADIAN FIRMS IS CONCENTRATED IN LARGE COMPANIES AND IN INDUSTRIES CHARACTERIZED BY COMPETITION AMONG THE FEW. ONLY 8 PERCENT OF TOTAL COMPANIES SURVEYED WERE FOREIGN CONTROLLED, BUT PERCENTAGE OF FOREIGN OWNERSHIP WAS 60 PERCENT FOR 100 LARGEST FIRMS AND 74 PERCENT FOR 100 NEXT LARGEST FIRMS. FOREIGN CONTROLLED FIRMS WERE ALSO FOUND TO BE MORE DIVERSIFIED THAN CANADIAN-OWNED COMPANIES. STATCAN NOTES THAT ALTHOUGH SURVEY WAS BASED ON 1972 DATA, RESULTS GENERALLY REMAIN VALID SINCE INDUSTRIAL STRUCTURE CHANGES SLOWLY. ENDERS

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